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No. 96-7185

IN THE
Supreme Court of the United States
OCTOBER TERM, 1996

GARRIT BATES,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF FOR THE PETITIONER

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27 pp

QUESTION PRESENTED

Must the United States of America prove fraudulent intent on the part of the defendant, Garrit Bates, as an essential element of the crime of knowingly and willfully misapplying federally insured funds, proscribed by 20 U.S.C. § 1097(a)?

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OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Seventh Circuit is reported at 96 Fed. 3d 964 and is set forth in its entirety as Petitioner's Appendix A, pages A-1 through A-13, to the Petition for Writ of Certiorari.

The Memorandum and Order of the District Court is unreported, but is set forth in its entirety as Petitioner's Appendix B, pages A-14 through A-23 to the Petition for Writ of Certiorari.

JURISDICTION STATEMENT

The Court of Appeals entered its judgement on September 20, 1996. The Petition for Writ of Certiorari was filed on December 23, 1996, and was granted on February 18, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

20 U.S.C. § 1097(a) provided, prior to its amendment in 1992, that:

> Any person who knowingly and willfully embezzles, misapplies, steals, or obtains by fraud, false statement, or forgery any funds, assets, or property provided or insured under the subchapter and part C of subchapter I of Chapter 34 of Title 42 shall be fined not more than $10,000 or imprisoned for not more than Five (5) years, or both; but if the amount so embezzled, misapplied, stolen, or obtained by fraud, false statement, or forgery does not exceed $200, the fine shall not be more than $1,000 and imprisonment shall not exceed One (1) year, or both.

STATEMENT OF THE CASE

A. Factual Background

Mr. Garrit (Jerry) Bates, began employment with Education America, Inc., in January of 1986. Education America, Inc., operated vocational and technical schools

located in Indiana and Wisconsin. Mr. Bates held the nominal title of vice-president of Education America, Inc., with his primary responsibility being overseeing student recruitment at various schools. Mr. Bates had no ownership interest in Education America, Inc.

In late 1988 or early 1989, Education America, Inc. realized that Acme Institute of Technology, located in South Bend, Indiana, ("Acme") was experiencing financial difficulty. As a result of this difficulty, Mr. Bates was given the additional responsibility in 1989 of determining which bills of Acme's were to be paid first, in an effort to steer the school through the financially troubled times. Ultimately, the efforts of Mr. Bates and others involved at Acme and Education America, Inc., were unsuccessful in resuscitating the financial health of the school, with Acme ceasing operations on June 5, 1990. At the time it ceased operations, Acme had unpaid refund liability under the guaranteed student loan program which was substantial.

In January 1991, Mr. Bates began employment with the Indiana Public Employees Retirement Fund where he presently remains employed. Mr. Bates voluntarily cooperated with the investigation of the Department of Education into the refund liability of Acme throughout the calendar year of 1992.

B. Procedural History

Mr. Bates was indicted by a federal grand jury on September 8, 1994. The indictment charged Mr. Bates with knowingly and willfully misapplying specified amounts of federally guaranteed student loan funds on twelve (12) separate occasions between January 15 and June 15, 1990, in violation of 20 U.S.C. § 1097(a) and 18 U.S.C. § 2. Mr. Bates moved to dismiss the indictment on February 7, 1995. Mr. Bates contended that the indictment did not reveal any allegd facts which would

support a conclusion that Mr. Bates had converted any funds guaranteed or furnished by the United States; and, that the indictment failed to allege that Mr. Bates intended to fraudulently convert funds guaranteed or owned by the United States Department of Education.

On April 17, 1995, the United States District Court entered its memorandum and order dismissing the indictment, agreeing with Mr. Bates that the indictment had failed to allege fraudulent intent on the part of Mr. Bates as an essential element of the crime. Specifically, the District Court found that the indictment was insufficient on its face in that each count of the indictment failed to state that Mr. Bates misapplied protected funds "with an intent to injure or defraud the United States."

On May 17, 1995, United States of America filed its notice of appeal. After submission of briefs, the matter was argued on February 12, 1996, before the United States Court of Appeals for the Seventh Circuit. The opinion of the Seventh Circuit was issued on September 20, 1996, reversing the United States District Court by vacating the judgment of the Court dismissing the indictment and reinstating the prosecution. In so doing, the United States Court of Appeals found that the specific intent of a defendant to injure or defraud the United States is not an element of the offense charged.

SUMMARY OF ARGUMENT

Mr. Bates is challenging the sufficiency of the indictment charging him with the offense of knowing and willfully misapplying funds in violation of 20 U.S.C. § 1097 (a). Specifically, Mr. Bates contends that the indictment did not set forth the essential elements of the offense charged, to-wit: (1) conversion of funds to his use or the use of another with (2) intent to defraud. Since the government has conceded, and the courts below have agreed, that conversion is an essential element of the offense, the central issue before the Court is whether or not

fraudulent intent is an essential element of criminal misapplication of funds as proscribed by § 1097(a).

Mr. Bates first argues that the plain language of the statute indicates the intent of Congress that specific intent is an element of the offense. Without question the phrase "knowingly and willfully" modifies the offenses of "embezzle," "misapply" and "steal" set forth in the statute. The term "knowingly" is often used to indicate a state of mind which harbors general intent. Here Congress has also used the term "willfully" in addition to "knowingly" in reference to the prohibited conduct. Since "willfully" should not be viewed as surplusage, the use of the phrase "knowingly and willfully" indicates the intent of Congress that the highest degree of mental culpability, specific intent, is an essential element of these offenses. In addition, the criminal sanctions of the Higher Education Act of 1965 embodied in § 1097(a) were enacted in 1980, twenty-eight (28) years following this Court's decision in *Morissette v. United States*. In *Morissette*, this Court found that statutory offenses which were variants of the common law crime of larceny were presumed to have retained the concept of mens rea as an element of the offense in the absence of express intent to the contrary. Congress is presumed to know the import of Supreme Court precedent in enacting statutes. The offense of "misapply" is found in a list of offenses which are variants of the common law crime of larceny and should therefore be presumed similar; these factors bolster the conclusion that the language of the statute indicates Congressional intent that "misapplication" include the element of specific intent.

Mr. Bates next argues that a definition of "misapplies" which includes the essential element of fraudulent intent fulfills the intent of Congres that the highest degree of mental culpability apply to the offenses of "embezzlement," "misapplication," and "stealing" under § 1097(a). In general usage the term misapplication is intrinsically vague in that it could emcompass a variety of acts. However the government has conceded, and the courts below agree that a type of conduct, (conversion) is an element of "criminal misapplication." The purpose of scienter is to disinguish innocent conduct from criminal conduct. By including fraudulent intent as an essential element of criminal misapplication of funds, the otherwest innocent conduct of maladministration of a business enterprise through unwise use of funds can be distinguished from criminal misapplication.

Mr. Bates further argues that the 1992 Amendment of § 1097(a) also supports this conclusion. This amendment criminalized the specific conduct "fail to refund" which is a possible result of the wrongful use, or misapplication of funds. This amendment constitutes a tacit acknowledgement by Congress that the offense of misapplication focuses on the use of the funds. Prior to 1992, the regulatory scheme did not sufficiently restrict the *use* of the funds at issue which apparently aliowed unwise use of these funds *without* fraudulent intent (i.e. maladministration) to proliferate and adversely affect student financial aid programs. The fact that this problem was addressed in Congress by specifically criminalizing the act of failing to make refunds and not merely by promulgation of regulations which would have provided more ways for an "unauthorized use" to be proven, reinforces the conclusion that Congress considered a § 1097(a) "misapplication" to include the element of fraudulent intent.

Mr. Bates also argues that the rule of lenity would support a reading of the statute requiring fraudulent intent as an essential element of the offense of misapplication of funds should the intent of Congress be found ambiguous. This would yield a less harsh result than any alternative reading posited by the government in the courts below and would not expand the reach of this statutory crime in the absence of clear Congressional intent to do so.

Having established that the essential elements of criminal misapplication of funds are conversion and fraudulent intent, Mr. Bates demonstrates that a critical examination of the indictment does not reveal facts supporting *either* of the essential elements of the offense because there are no specific allegations as to how the funds in question were actually used. Further, although the individual counts of the indictment are set forth in the words of the statute, they are not free of uncertainty and ambiguity. Because of these failings, the indictment is deficient on its face and should be dismissed.

ARGUMENT

I. MR. BATES MAINTAINS THAT THE INDICTMENT BY WHICH HE WAS CHARGED WITH VIOLATIONS OF 20 U.S.C. § 1097(a) IS DEFICIENT ON ITS FACE AND SHOULD BE DISMISSED.

Mr. Bates is challenging the sufficiency of the indictment. An, ". . . indictment . . . shall be a plain, concise and definite written statement of the essential facts constituting the offense charged." Fed. R. Crim. Proc. 7(c)(1). It has long been understood that an indictment must be more strictly examined for sufficiency if challenged prior to the rendering of a verdict on the merits of the case. *See, Hagner v. United States,* 285 U.S. 427 (1932). This case finds itself before the Court as a result of the granting of a motion to dismiss by the United States DistrictCourt for the Northern District of Indiana prior to commencement of trial, a subsequent reversal by the United States Court of Appeals for the Seventh Circuit and grant of Writ of Certiorari by this Court. Under these circumstances a strict review of the indictment should apply.

This Court has succintly stated its standard for determining the sufficiency of an indictment as follows:

> Our prior cases indicate that an indictment is sufficient if it, first, contains the elements of the offense charged and fairly informs the defendant of the charge against which he must defend, and, second, enables him to plead an acquittal or conviction in bar of future prosecutions for the same offense. . . . [citations omitted] . . . it is generally sufficient that an indictment set forth the offense in the words of the statute itself, as long as "those words of themselves fully, directly and expressly, without any uncertainty or ambiguity, set forth all the elements necessary to constitute the offense intended to be punished." *United States v. Carll,* 105 U.S. 611, 612, 26 L.Ed. 1135 (1882).

Hamling v. United States, 418 U.S. 87, 117 (1974).

Mr. Bates contends that the indictment at issue in this case does not meet the foregoing standard.

To properly resolve the case before the Court, the essential elements of the offense of "knowingly and willfully misapplying funds provided an insured under subchapter IV chapter 28 of Title 20 of the United States Code", must be identified. Mr. Bates asserts that the definition of a criminal misapplication of funds includes: (1) a conversion of property to the use of the defendant or a third party, and, (2) fraudulent intent. *See, United States v. Kammer,* 1 Fed. 3d 1161, 1165 (C.A. 11th, 1993). Mr. Bates submits that for the indictment to have sufficiently apprised him of the charges asserted by the government, in addition to the introductory factual allegations, the portion of the indictment charging each count should, at a minimum, read as follows:

> On or about [*a given date*], in the Northern District of Indiana, Garrit Bates, a/k/a Jerry Bates, defendant herein, did knowingly and willfully misapply funds, to wit: [*dollar amount*], provided an insured under subchapter IV of chapter 28 of Title 20 of the United States Code *by converting said funds to his use or the use of another with the intent to defraud.*

II. THE LANGUAGE OF 20 U.S.C. § 1097(a) INDICATES THE INTENT OF CONGRESS THAT THE OFFENSE OF MISAPPLICATION OF FUNDS CONTAIN THE ESSENTIAL ELEMENT OF SPECIFIC INTENT.

Resolution of the issue presented in this case presents a problem of statutory construction. The starting point of an inquiry into statutory construction is the language of the statute itself. *Staples v. United States*, 511 U.S. 600, 114 S.Ct. 1793, 1796, citing *Connecticut National Bank v. Germain*, 503 U.S. 249. In the absence of a clearly expressed legislative intention to the contrary, the language of the statute itself must ordinarily be regarded as conclusive. *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108.

The statute at issue defines a federal offense for "[a]ny person who knowingly and willingly embezzles, misapplies, steals, or obtains by fraud, false statement or forgery any funds, assets, or property provided or insured under the subchapter and part C of subchapter I of chapter 34 of Title 42 . . .". Specifically, Mr. Bates was charged in a twelve (12) count indictment that he "did knowingly and willingly misapply funds . . ., provided and insured under subchapter IV of chapter 28 of Title 20 of the United States Code." [J.A. pp. 6-17].

The government, arguing in the courts below, has maintained that the definition of "misapplication" of funds under § 1097(a) is simply "conversion of funds to the defendant's own use, or the use of others". Obviously, the main disagreement between Mr. Bates and the Government is whether or not fraudulent intent is an essential element of the offense of misapplication of funds under § 1097(a).

This Court is often called upon to determine the existence or non-existence of scienter as an element of offenses created by statute where Congress has not included specific

language in the statute as indicia of its intent. However, such is not the case in construing the offense of "misapplication" proscribed by 20 U.S.C. § 1097(a), as Congress has stated that to commit the offense the actor must engage in the prohibited conduct "knowingly and willfully".

Here, Congress has specifically employed the term "knowingly" in reference to the prohibited conduct. "Knowingly" has been found to indicate, at the very least, a state of mind encompassing a low degree culpability roughly synonymous with general intent at common law. See, *United States v. Bailey*, 444 U.S. 394 (1980). However, in addition to "knowingly," Congress has also employed the term "willfully" to describe the state of mind necessary to constitute prohibited conduct within the ambit of § 1097(a). This Court is hesitant to view a statutory term as surplusage, or as having no consequence. See, *Ratzlaf v. United States*, 510 U.S. 135, 140. In fact, this Court ". . . presumes that each term in a criminal statute carries meaning." *United States v. Wells*, 119 S. Ct. 921, 929. If "willfully" is not considered surplusage and given meaning, a conclusion is supported that Congress intended (by requiring willful conduct in addition to knowing conduct) that the highest degree of mental culpability (specific intent) be required to establish the offenses of "embezzlement," "misapplication" or "stealing" under § 1097(a).

This Court also ". . . presume[s] that Congress expects its statutes to be read in conformity with this Court's precedents. . . ." *Wells*, at 929. The Higher Education Act of 1965 of which 20 U.S.C. § 1097(a) is a part, was enacted some thirteen (13) years subsequent to this Court's landmark decision in *Morissette v. United States*, 342 U.S. 246 (1952), with the criminal provisions of § 1097(a) being enacted in 1980. In *Morissette*, this Court engaged in a lengthy and insightful analysis of the importance of scienter in defining criminality under the common law. Because of the importance of mens rea or

scienter as elements of common law crimes, this Court found that, in the absence of specific congressional intent to the contrary, the mere lack of language indicating a mens rea requirement did not necessarily mean that this element of the offense had been abandoned by Congress. Against that backdrop, the Court held that criminal intent is an essential element of the crime of "knowing conversion" of property of the United States in violation of 18 U.S.C. § 641. In reaching this conclusion this Court noted that:

> Stealing, larceny, and its variants and equivalents, were among the earliest offenses known to the law that existed before legislation; they are invasions of rights of property which stir a sense of insecurity in the whole community and arouse public demand for retribution, the penalty is high and, when a sufficient amount is involved, the infamy is that of a felony, which, says *Maitland* is . . . as bad a word as you can give to man or thing.

Morissette at p. 260.

It is important to note that in § 1097(a) the offense of "misapplication" is sandwiched between the offenses of "stealing" (one of the earliest offenses known to the law) and "embezzlement," a variant of larceny, which was ". . . borrowed from the common law where scienter was historically required . . .". *United States v. Freed*, 401 U.S. 601, 607 (1971). Since Congress is presumed to have been aware of the view of this Court (as expressed in *Morissette*) that scienter is an essential element of the variant forms of the common law crime of larceny, the inclusion of "misapplication" in a list of these variant offenses would infer that Congress considered all of these offenses to be similar. As this Court has observed, a ". . . familiar principle of statutory construction is that words grouped in a list should be given related meaning." *Securities Industry Association v. Board of Governors of*

the Federal Reserve System, 468 U.S. 137, 167 (1984). Accordingly, support is given to a conclusion that the plain language of the statute indicates Congressional intent that the prohibited offenses, including "misapplication," be committed with specific intent on the part of a defendant.

III. THE INTENT OF CONGRESS IS FULFILLED BY A DEFINITION OF "MISAPPLIES" UNDER 20 U.S.C. § 1097(a) WHICH INCLUDES THE ESSENTIAL ELEMENT OF FRAUDULENT INTENT.

It is quite clear, and the government has never contended otherwise, that the phrase, "knowingly and willfully" modifies the terms "misapplies" and "steals" as well as "embezzles," set forth in § 1097(a). Since Congress intended (by proscribing "knowing and willfull" conduct) to require proof of the highest degree of mental culpability for each of these offenses (e.g. specific intent), one must next examine the impact of this requirement upon the specific offense of misapplication of funds which was alleged by the government to have been violated by Mr. Bates.

In performing this analysis, it seems logical that the first step would be to identify the specific acts or type of conduct encompassed by the term "misapplication." An ordinary or common sense understanding of the term is vague, in that many different acts could conceivably constitute "misapplication" in general usage. Indeed, the "legal definition" of misapplication supplied by Black's Law Dictionary, Revised Fourth Edition, adds very little definiteness of understanding to the term by defining "misapplication" as follows: "Improper, illegal, wrongful, or corrupt use or application of funds, property, etc." However, many courts, including the courts below, are in agreement that a certain type of conduct, that is, conversion, is an element of the offense of criminal misapplication as proscribed by § 1097(a). See, *United States v. Bates*, 96 Fed. 3d 964 (C.A. 7th, 1996); *United States v.*

Kammer, 1 Fed. 3d 1161 (C.A. 11th, 1993); *United States v. Brown*, 742 Fed. 2d 363 (C.A. 7th, 1984); *United States v. Jakeway*, 783 F. Supp. 590 (M.D. Fla. 1992); *United States of America v. Garrit Bates, Memorandum and Order of United States District Court for the Northern District of Indiana*. [Pet. App., pp. A-14 to A-23]. Even the government, in the instant case, conceded that conversion was an element of the offense of misapplication of funds under § 1097(a). [Pet. App. p. A-7].

The underlying purpose of a scienter requirement is to separate innocent conduct from criminal behavior. "Criminal intent serves to separate those who understand the wrongful nature of their act from those who do not, but does not require knowledge of the precise consequences that may flow from that act once aware that the act is wrongful." *United States v. X-Citement Video*, 115 S. Ct. 464, 469 n.3 (1994). In the very real circumstances presented in this case, the scienter requirement would serve to distinguish between criminal misapplication of funds and mere maladministration of a business enterprise which failed. See, *United States v. Britton*, 107 U.S. 655, 667 (1883). The purpose of Congress in requiring that the highest degree of mental culpability apply to criminal misapplication under § 1097(a) must surely have been to ensure that criminal sanctions were not applied to those individuals who committed acts of poor judgement or negligence which may merely form the basis for a civil remedy. This Court recently pronounced that the "scienter requirement should apply to each of the statutory elements which criminalize otherwise innocent conduct." *X-Citement Video*, p. 469. Where the only overt act of a defendant which may be offered to prove the offense of criminal misapplication is that the defendant exercised dominion or control over the property of another to his benefit or the benefit of a third party, the factor which would separate otherwise innocent conduct from criminal

activity would be whether or not the defendant intended by his conduct to defraud.

The inclusion of fraudulent intent as an essential element of criminal misapplication under § 1097(a), therefore, satisfies the congressional intent that the crime contain the highest degree of mental culpability.

IV. THE VIEW THAT CONGRESS UNDERSTANDS THE DEFINITION OF "MISAPPLY" IN 20 U.S.C. § 1097(a) TO CONTAIN THE ESSENTIAL ELEMENT OF FRAUDULENT INTENT IS ALSO SUPPORTED BY CONGRESS' 1992 AMENDMENT OF THE STATUTE AND REGULATIONS.

Mr. Bates was indicted for conduct which allegedly occurred in 1990. The allegations of misconduct against Mr. Bates are not unambiguously stated; they possibly consist of twelve (12) instances where refunds due insured lenders under the guaranteed student loan program were not made.

In 1992, Congress amended 20 U.S.C. § 1097(a) to read:

> Any person who knowingly and willfully embezzles, misapplies, steals, obtains by fraud, false statement or forgery, or fails to refund, any funds, assets or property provided or insured under the subchapter and part C of subchapter I of chapter 34 of Title 42 or attempts to so embezzle or misapply, steal, obtain by fraud, false statement or forgery or fail to refund any funds, assets or property shall be fined not more than $20,000.00 or imprisoned for not more than 5 years or both except if the amount so embezzled, misapplied, stolen, obtained by fraud, false statement, or forgery, or failed to be refunded does not exceed $200.00, then the fine shall not be more than $5,000.00 and imprisonment shall not exceed 1 year or both.

The 1992 Amendment of § 1097(a) by Congress seemingly was intended to impose new duties upon schools and

clarify the potential criminal liability of those entities who fail to make refunds. This concept is supported by the fact that the Department of Education promulgated amendments to its regulations, subsequent to the 1992 amendment to the statute, which significantly affected the manner in which a school must process and apply a student borrower's loan proceeds. These regulations specifically address the obligation of the school regarding loan proceeds which a student requests in writing be retained by the school so as to assist the student in managing his or her loan funds for the remainder of the academic year. As of July 1, 1993, 34 C.F.R. § 682.604(d)(1)(ii)(B) mandated, in pertinent part, that: "The school shall deposit these funds in a designated trust account and may not commingle them with other funds or use them for any other purpose." Prior to the addition of this language, a participating school was permitted to commingle unearned student loan funds with other funds which were used in the operation of the institution,—as the government alleges was done by Acme.

Even though Acme and other participating schools were allowed to commingle these funds, Mr. Bates acknowledges that the legislative history of 20 U.S.C. § 1097(a) does indicate that the language of § 1097(a) was broad enough to include prosecuting the failure to make refunds as a result of a criminal misapplication of funds. That this was the intent of Congress was clearly set forth by United States Senator Landen Kassenbaum in her correspondence of February 28, 1992, to Mr. James B. Thomas, Jr., Inspector General of the United States Department of Education. [J.A. p. 24]. Senator Kassenbaum was a sponsor of the legislation which amended § 1097(a) in 1992. Senator Kassenbaum explains that Congress understood its original intent to be that a knowing and willful failure to make refunds could appropriately be prosecuted as a misapplication of Title IV funds, but it was her intent and the intent of Congress through the 1992 amendment to

facilitate prosecution of such conduct by specifically referencing it in the statute.

Mr. Bates submits that the mere fact that a failure to make refunds could properly be prosecuted as the result of a knowing and willful misapplication of funds does not mean that, prior to July 23, 1992, the failure to timely make refunds, *in and of itself* constituted a criminal violation of 20 U.S.C. § 1097(a). In 1992, Congress made the prosecution of this conduct easier by specifically proscribing the conduct of failing to make refunds, thereby eliminating the necessity to show that there was a "misapplication" which resulted in a failure to make refunds. This manner of amending the statute constitutes a tacit acknowledgement by Congress that the offense of "misapplication" focuses on the manner in which the funds were used. A regulatory scheme which, prior to 1992, did not stringently restrict the use of student loan proceeds by a school, combined with a statutory offense which required misuse of funds with fraudulent intent, apparently allowed innocent conduct which constituted maladministration to proliferate and adversely impact student financial aid programs. The fact that Congress addressed this concern by creating the particularized offense of "fails to refund" and by the promulgation of more stringent regulations reinforces the conclusion that Congress knew misapplication under § 1097(a) contained the essential element of intent to defraud. Had fraudulent intent not been an element of "misapplication" promulgation of regulations severely restricting the use of funds could have addressed the problem by merely providing more ways to prove an "unauthorized use" of funds.

V. APPLICATION OF THE RULE OF LENITY RESOLVES ANY POTENTIAL AMBIGUITY IN THE DEFINITION OF "KNOWINGLY AND WILLFULLY MISAPPLIES" TO INCLUDE THE ESSENTIAL ELEMENT OF FRAUDULENT INTENT.

It is conceivable that the government will argue that the intent of Congress is not clear and that the statute in question is susceptible of another reasonable reading regarding whether or not fraudulent intent is an essential element of the offense of knowing and willful misapplication of funds in violation of 20 U.S.C. § 1097(a). If such is the case, Mr. Bates submits that any such ambiguity would be resolved in his favor by application of the rule of lenity. This Court has recognized that the ". . . 'touchstone' of the rule of lenity 'is statutory ambiguity'. . . . lenity thus serves only as an aid for resolving an ambiguity; it is not to be used to beget one." *Albernaz v. United States*, 450 U.S. 333, 342 (1981). See, also, *United States v. Thompson/Center Arms Company*, 504 U.S. 505 (1992).

Generally, the rule of lenity means that courts will adopt the less harsh meaning of a statute where the intent of Congress is ambiguous. See, Black's Law Dictionary, Fourth Edition.

> Application of the rule of lenity ensures that criminal statutes will provide fair warning concerning conduct rendered illegal and strike the appropriate balance between the legislature, the prosecutor and the court in defining criminal liability. See, *United States v. Bass, supra,* 404 U.S., at 348, 92 S.Ct., at 523 ('[B]ecause of the seriousness of criminal penalties, and because criminal punishment usually represents the moral condemnation of the community, legislatures and not courts should define criminal activity')."

Liparota v. United States, 471 U.S. 419, 427 (1985).

This Court has also acknowledged that ". . . the doctrine which denies to the federal judiciary power to

create crimes forthrightly admonishes that we should not enlarge the reach of enacted crimes by constituting them from anything less than the incriminating components contemplated by the words used in the statute." *Morissette v. United States*, 342 U.S. 246, 263 (1952).

In the case at hand, a reading of 20 U.S.C. § 1097(a) which would require proof of fraudulent intent as an essential element of the crime of knowingly and willfully misapplying federally insured funds would be less harsh than any alternative reading of this statute proposed by the government in the courts below. Further, such a reading would ensure that the judiciary did not enlarge the reach of this statutory crime without a clear statement from Congress that criminal intent was not an essential element of said crime.

Application of the rule of lenity, if appropriate, supports Mr. Bates' position in this case that fraudulent intent is an essential element of "knowing and willful misapplication" of funds in violation of § 1097(a).

VI. THE INDICTMENT FAILS TO ALLEGE FACTS SUFFICIENT TO INFER THAT MR. BATES CONVERTED FUNDS WITH THE INTENT TO DEFRAUD; NOR, DO THE WORDS OF THE STATUTE UNAMBIGUOUSLY SET FORTH THE ESSENTIAL ELEMENTS OF THE OFFENSE CHARGED PURSUANT TO 20 U.S.C. § 1097(a).

Having established in the preceding sections that the offense of "knowingly and willfully misapplying" funds as proscribed by 20 U.S.C. § 1097(a) contains the essential elements of (1) conversion, and, (2) fraudulent intent, it must now be determined whether the indictment is sufficient under the standards set forth in *Hamling*.

The factual allegations of the indictment do not contain any facts from which it could be inferred that Mr. Bates either *converted* or harbored any *intent to defraud* anyone

by the alleged acts. Scrutiny of the sixteen (16) introductory paragraphs of the indictment reveal only the following *vis-a-vis* Mr. Bates' status or actions, or the actions of any person with whom he was associated: (a) that Mr. Bates was treasurer of the Board of Trustees of Acme, [J.A. p. 2; indictment, paragraph 1]; (b) that Mr. Bates was vice-president of Education America, a for-profit corporation, [J.A. p. 2; indictment, paragraph 2]; (c) that James W. Jackson, the president of Acme had signed a program participation agreement with the Department of Education on behalf of Acme, and that Mr. Bates did sign a program participation agreement on behalf of another school operated by Education America, [J.A. p. 3; indictment, paragraph 5]; (d) that the decisions of James W. Jackson and Laurenda Jackson as well as Mr. Bates resulted in the failure of Acme to pay refunds which were due lending institutions under the guaranteed student loan program in which Acme participated, [J.A. p. 4; indictment, paragraph 6]; (e) that Mr. Jackson had corresponded with the director of Acme and the director of Interstate Technical Institute, located in Ft. Wayne, Indiana, instructing the schools to remit a ten (10%) percent management fee to Education America, and a regular salary for James and Laurenda Jackson on a monthly basis, and that Mr. Bates had oversight authority at Interstate Technical Institute, [J.A. p. 4; indictment, paragraph 7]; (f) that Education America discontinued the use of a special bank account which segregated unearned income from the general account of Acme, [J.A. pp. 4-5; indictment, paragraph 9]; (g) that in early 1989, Mr. Bates began determining which bills would or would not be paid with the understanding that payments to Mr. and Mrs. Jackson and Education America and other bills took priority over payments of refunds; and, that Mr. Bates specifically instructed Acme employees not to make student loan refunds, [J.A. p. 5; indictment, paragraph 11]; (h) Mr. Bates released the financial aid director of Acme from

all responsibility concerning refunds on guaranteed student loans, at her request. However, the financial aid director was advised to continue to prepare refund documents to be approved by the corporation for payment, [J.A. p. 5; indictment, paragraph 12]; (i) and, when Acme ceased operations on or about June 5, 1990, unrefunded, unearned income from the guaranteed student loan program had accrued to a total amount of One-Hundred Thirty-nine Thousand Six Hundred Forty-nine and No/100 ($139,649.00) Dollars during the period that Mr. Bates acted as the chief financial officer of Acme, [J.A p. 6; indictment, paragraph 15-16].

A careful reading of the factual allegations of the indictment reveals that it does not state how student loan proceeds were *actually used* by Acme during the period that Mr. Bates was making day-to-day decisions on payment of financial obligations of Acme. Since there is no specific statement regarding the actual use of these funds, it is impossible to make a determination as to whether or not any such use was in fact allowed under the civil regulations. This omission by the government is especially important in light of the fact that no Department of Education regulations prohibited commingling of student loan funds with other operating funds of a school in 1989 and 1990. The factual allegations of the indictment simply do not support a conclusion that a conversion is being charged as an essential element of the offense.

Similarly, the factual allegations of the indictment do not support an inference that Mr. Bates harbored an intent to defraud anyone as the second essential element of the offense of knowingly and willfully misapplying funds. Without knowing how the funds in questions *were actually used* it is simply impossible to infer an intent to defraud from Mr. Bates alleged conduct. The factual allegations simply do not state the essential element of fraudulent intent.

The portion of the indictment setting forth the twelve (12) specific counts of violation of 20 U.S.C. § 1097(a) merely describe the offense in the words of the statute itself. Therefore, it must be determined whether or not the words of the statute "fully, directly, and expressly, without any certainty or ambiguity, set forth all of the elements necessary to constitute the offense intended to be punished." See, *Hamling, supra* p. 117. Mr. Bates submits that they do not, as to either essential element of the offense. As pointed out hereinabove, the word "misapplication" is intrinsically vague since a variety of acts or conduct could, under appropriate circumstances, be considered misapplication. Something more definite must be stated to give a defendant enough information to defend the allegations. An explanatory phrase describing the conduct complained of by the government which falls within the ambit of "misapplication" is necessary to apprise the defendant that an essential element of offense is conversion.

Further, the phrase "knowingly and willfully," in the absence of precedent on the precise issue, is ambiguous, as it can be taken to mean simply that a defendant intentionally did some act. Thus, the specific counts of the indictment also harbor uncertainty as to whether or not the government must prove fraudulent intent as an essential element of the crime.

Because of these uncertainties and because the factual allegations do not specifically inform the defendant as to how the funds in question were *actually used*, the indictment does not meet the standard set forth in *Hamling* and is defective on its face.

CONCLUSION

For the foregoing reasons, the judgement of the United States Court of Appeals for the 7th Circuit should be vacated and the indictment of Mr. Bates dismissed.

Respectfully submitted,

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